

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

1023 SCOMM 28: JOINT GAS PIPELINE COMMITTEE, 1981-82

SETTLEMENT AGREEMENT

A. Introduction and Summary

Construction of the Trans-Alaska Pipeline System ("TAPS" or the "System") was completed during 1977, and during that year petroleum began to flow from Prudhoe Bay through the System to Valdez, where it was (and is) loaded onto tankers for transport to its destination. Since the first TAPS tariffs were filed in May and June of 1977, the companies that own the System have been defending their tariff rates in administrative litigation (now denominated FERC Docket No. OR78-1 and identified herein as the "TAPS rate case") brought by the State of Alaska, the United States Department of Justice, the Arctic Slope Regional Corporation, the staff of the Alaska Public Utilities Commission ("APUC"), and the staff of the Interstate Commerce Commission (prior to October 1, 1977) and the Federal Energy Regulatory Commission (after October 1, 1977) (the "Protestants").

An initial decision in Phase I of the litigation was rendered by an Administrative Law Judge on February 1, 1980, and argued before the Federal Energy Regulatory Commission ("FERC" or the "Commission") on July 1, 1980, but the Commission has yet to issue its decision in Phase I of the case. Evidentiary hearings in Phase II of the litigation began in

February of 1982 and will consume many months. Given the likelihood of appeal, it seems fair to say that absent a settlement no end to the TAPS rate case is yet in sight.

After considering the history and prospects of the litigation, and the uncertainty it has created for the eight pipeline companies that own TAPS (the "TAPS owners" or "owners") and the State of Alaska (the "State"), the owners and the State began some months ago to explore ways of settling the litigation. Following lengthy negotiations, the State and one of the owners -- BP Pipelines Inc. ("BP") -- have agreed to settle all of the issues in Docket No. OR78-1 on the terms set forth below. BP and the State have determined that the benefits that each will derive from this Settlement -- both pecuniary and non-pecuniary -- are such that it is superior to continued litigation and that each will receive adequate consideration for its agreement to enter into the Settlement.

The State and BP do not seek to impose this Settlement upon the other TAPS owners and, with one exception, the Settlement's terms do not depend upon its acceptance by TAPS owners other than BP. The State is prepared to settle with each TAPS owner on equivalent terms, however, and both the State and BP hope that all of the TAPS owners, as well as the Department of Justice, the Arctic Slope Regional Corporation, the APUC staff, and the FERC staff, will join in the Settlement.

The terms and conditions of the Settlement are,
briefly, as follows:*/

(1) Concurrent with the filing of the Settlement with the FERC, those settling owners whose tariffs exceed \$5.50 per barrel will reduce their tariffs to \$5.50 per barrel. Shortly after FERC approves the Settlement, the settling owners will file new tariffs not to exceed \$4.625 per barrel for shipments of Sadlerochit petroleum from Pump Station 1 of TAPS to Valdez.

(2) The Settlement Agreement shall remain in effect for ten years from its effective date, subject to annual adjustments for inflation, throughput variations, extraordinary events, and tax changes. There are no provisions for modification, extension, or renewal of the Agreement at the end of that period, and it is the intention of the parties that the Agreement shall have no precedential value.

(3) The settling owners will not refund any portion of the tariffs collected prior to the effective date of the Settlement. They will, however, reimburse the State for their proportional share of all costs (including legal fees) that the State incurred to prosecute the TAPS rate case.

(4) The settling owners will reduce their carrier property accounts by their proportional share of \$400 million (if all TAPS owners join in the Settlement) or \$500 million (if all TAPS owners do not join in the Settlement).

(5) The State will dismiss all of its claims against the settling owners in Phase II of the TAPS rate case with prejudice. The settling parties will also dismiss all of their claims in Phase I of the TAPS rate case, but without prejudice to their rights to reassert those claims at the termination of the Settlement for the period following said termination.

*/ The actual terms and conditions of settlement are set forth in Parts B, C and D of this Agreement. In the event of any disagreement between this Part and Parts B, C & D, Parts B, C & D control.

(6) If all of the Protestants are not bound by this Settlement Agreement, or if the FERC fails to give it timely approval, the Agreement shall be void and of no further force and effect.

B. Definitions

Effective Date - The first day of the month following the month in which the Commission approves the Agreement.

Extraordinary Event - Act of God, act of war, storm, flood, glacial surge, civil disorder, seismic event or other similar catastrophe. Corrosion, subsidence, or a collapse, fire, explosion, accident or similar event shall also be deemed an Extraordinary Event if the TAPS owners can demonstrate that the event could not have been prevented by their exercise of reasonable prudence.

Index - The most recent published estimate of the Implicit Price Deflator for Gross National Product, as published by the Bureau of Economic Analysis of the United States Department of Commerce, or any successor thereto, in the "Survey of Current Business."

Measurement of Time - Year 0 is the one year period immediately preceding the Effective Date. Year 1 is the year commencing on the Effective Date. The year designated as year "n" is a year following year 1 which commences on the "n-1" anniversary of the Effective Date.

Net Barrels - Barrels of 42 U.S. standard gallons at 60°F net of basic sediment and water as recorded on the loading ticket at Valdez.

Proportional Share - All figures in this Agreement are expressed on a System-wide basis. Whenever a cost, expense, adjustment, payment or benefit is to be apportioned among the TAPS owners, each owner's portion of the total -- its "proportional share" -- shall be equal to its composite percentage ownership share of TAPS on the Effective Date.

Settling Owner - Any TAPS owner who has executed this Agreement and agreed to be bound by its terms.

Settling Party - Any party to the TAPS rate case who has executed this agreement and agreed to be bound by its terms.

Throughput - $[V_n]$ - The volume of petroleum, measured in millions of net barrels (rounded to the nearest tenth of a million), loaded onto vessels at the System terminal at Valdez during the twelve months commencing on the n-1 anniversary of the Effective Date.

C. Terms and Conditions

C.1 Tariff Equation

The maximum allowable tariff per barrel for shipments of Sadlerochit petroleum from Pump Station 1 to Valdez terminal in year 1 shall be \$4.625. In year n the maximum allowable tariff $[T_n]$ shall be computed as follows and rounded to the nearest one tenth of one cent:

$$T_n = \$4.625[A_n][B_n] + [C_n] + [D_n] \quad (\text{Equation C.1})$$

In Equation C.1:

\$4.625 = the Base Tariff

- A = the Inflation Adjustment, as defined in paragraph C.2, infra.
- B = the Throughput Adjustment, as defined in paragraph C.3, infra.
- C = the Tax Adjustment, as defined in paragraph C.4, infra.
- D = the Extraordinary Event Adjustment, as defined in paragraph C.5, infra.

C.2 Inflation Adjustment

The Inflation Adjustment $[A_n]$ in year n shall be computed as follows:

$$A_n = 1 + [(I_{n-1} - I_0)/(I_0)][H] \quad (\text{Equation C.2})$$

In Equation C.2:

I_{n-1} = the Index for the quarter prior to the quarter in which year n began.

I_0 = the Index for the quarter prior to the quarter that included the Effective Date.

H = the Adjustment Factor, determined as follows:

$(I_{n-1} - I_{n-2})/(I_{n-2})$	<u>H</u>
.12 or less	.4
More than .12 to .16	.6
More than .16 to .20	.67
More than .20	.75

where

I_{n-2} = the Index for the quarter prior to the quarter in which year n-1 began.

C.3 Throughput Adjustment

The Throughput Adjustment $[B_n]$ in year n shall be computed as follows:

$$B_n = (584)/(292 + .5V_{n-1}) \quad (\text{Equation C.3})$$

In Equation C.3:

$$V_{n-1} = \text{Throughput in year } n-1.$$

Provided that $B_n = 1$ unless V_{n-1} is greater than 596 (million barrels) or less than 572 (million barrels).

C.4 Tax Adjustment

The Tax Adjustment $[C_n]$ for year n shall be computed as follows:

$$C_n = [E_n] + [F_n] + [G_n] \quad (\text{Equation C.4})$$

In Equation C.4:

$$\begin{aligned} E_n &= [1 - TR_{n-1}] [(AVT_{n-1} - 162)/(V_{n-1})] \\ F_n &= .03T_{n-1} [1 - TR_{n-1}] \{ [(SR_{n-1})/(.094)] - 1 \} \\ G_n &= .21T_{n-1} \{ [(TR_{n-1})/(.46)] - 1 \} \end{aligned}$$

where

TR_{n-1} = the maximum Federal tax rate on taxable corporate income as provided in section 11(b) of the Internal Revenue Code of 1954 and/or any successor thereto.

AVT_{n-1} = The combined ad valorem taxes paid by all TAPS owners in year $n-1$, in millions of dollars.

SR_{n-1} = the maximum State tax rate on the taxable corporate income of pipeline companies, as provided in AS 43.20.011(e) and/or any successor thereto.

Provided that $E_n = 0$ unless AVT_{n-1} is greater than \$174 million or less than \$150 million; $F_n = 0$ unless SR_{n-1} is greater than .099 or less than .089; and $G_n = 0$ unless TR_{n-1} is greater than .48 or less than .44.

And provided further that if at any time during the term of this Agreement the State fundamentally alters the basis or methodology used to compute the income tax liability of the settling owners (e.g. from the unitary method to individual accounting), or levies a new tax on the settling owners of a kind or type that is not in effect on the date this Agreement is filed with the FERC (e.g. a gross receipts tax), and if the net effect of the alteration and/or the new tax is an increase of more than \$12 million in the combined annual tax liability to the State of all TAPS owners, then [F] in succeeding years shall be computed as follows:

$$F_r = [1 - TR_{r-1}] [(ST_{r-1} - ST_0)/(V_{r-1})]$$

where

r = 0 (zero) for calendar year 1982 and increases by 1 on January 1 of each succeeding calendar year.

ST_{r-1} = the total annual non-ad valorem tax liability of the TAPS owners to the State in year $r-1$

ST_0 = the total annual non-ad valorem tax liability of the TAPS owners to the State in calendar year 1982, as determined under the law in effect on the date this Agreement is filed with the FERC.

C.5 Extraordinary Events Adjustment - If the occurrence of an Extraordinary Event in year n mandates expenditures in excess of the sum of the Extraordinary Event Deductible (J_n) and any amounts reasonably recoverable from insurers or

third parties, such excess expenditures may be recovered over the five years following the year during which repair, replacement or reconstruction of the damage or loss occasioned by the Extraordinary Event is completed, by the addition of an Extraordinary Event Adjustment $[D_n]$ to the tariff in each such year, computed as follows:

$$D_n = \left(\frac{K}{V_{n-1} \times 10^6} \right) \left(1 - \frac{I_q}{(1+I_q)^5} \right) \text{ (Equation C.5)}$$

where

$$J_n = \left(1 + [(I_{n-1} - I_0)/(I_0)] \right) (\$50,000,000)$$

I_q = the difference between the Index for the quarter in which the Extraordinary Event occurred and 95% of the Index for the same quarter of the preceding year, divided by the Index for the same quarter of the preceding year.

K = Expenditures necessitated by an Extraordinary Event that exceed the sum of J_n and any amounts reasonably recoverable from insurers or third parties, plus imputed interest on advances of repair, replacement or reconstruction funds made after expenditure of, and in excess of, the sum of J_n and said reasonably recoverable amounts at a rate per annum equal to I from the date of each such advance until the anniversary of the Effective Date following completion of repairs, replacement or reconstruction.

Provided that no settling owner shall be eligible for an Extraordinary Event Adjustment unless it maintains, in full force and effect, property and casualty insurance on its interest in TAPS that is neither narrower in scope of coverage nor smaller in amount (adjusted for inflation) than that in effect for such owner on January 1, 1982.

C.6 Pumpability Adjustment - Filed tariffs for petroleum from formations other than the Sadlerochit formation may differ from the tariff $[T_n]$ computed pursuant to paragraph C.1 of this Agreement, but any such difference shall be reasonable, non-discriminatory, and computed solely to reflect differences in pumpability.

D. Additional Provisions

D.1 Termination - This Agreement shall terminate on the tenth anniversary of the Effective Date (the "termination date"). It is the intention of the settling parties that this Agreement have no precedential value or effect.

D.2 Litigation Expenses - Within 30 days of submission of the Settlement Agreement to FERC the State shall submit to the settling owners a complete accounting, with such support as may be reasonably required to verify amounts expended, of the costs it has incurred in prosecuting and settling the TAPS rate case since June of 1976, including fees and costs actually paid to attorneys and consultants, and costs incurred for communications, travel, transcripts, duplicating, postage, storage, and delivery (collectively "TAPS litigation expenses"). Within 90 days of the Effective Date, the State shall submit to the settling owners a complete accounting, with such support as may be reasonably required to verify amounts expended, of the State's TAPS litigation expenses through the Effective date and for two months thereafter. Provided,

that the State's average daily TAPS litigation expenses for the period between the last day included in the first accounting and the end of the second month following the Effective Date shall not exceed the State's average daily TAPS litigation expenses for year 0.

Within 30 days of FERC's approval of the Settlement or 30 days of the State's second submission hereunder, whichever occurs later, each settling TAPS owner shall remit to the State its proportional share of the State's total TAPS litigation expenses, as submitted. If the FERC order approving this Agreement is appealed, and as a consequence of such appeal is reversed or vacated (in whole or in substantial part) by a court of competent jurisdiction, then the State shall refund any amounts it has received pursuant to this paragraph within 60 days of the issuance of the court's mandate.

D.3 Refunds - In consideration for the payment of litigation expenses described in paragraph D.1 and the other terms and conditions of this Agreement, the State agrees to withdraw, with prejudice, its claim for a partial refund of the tariffs collected by the settling TAPS owners for shipments prior to the Effective Date. The settling parties agree that neither the State nor any other person shall be required, by virtue of this paragraph, to return any refunds previously paid by any TAPS owner to the State or any other person. It is a

condition of this Agreement that the FERC order approving the Settlement provide that the settling owners shall not be required to refund any portion of the tariffs collected for shipments prior to the Effective Date. Provided, that this paragraph shall not extend to any refund that may become due by virtue of an election of a settling owner under paragraph 3 of the Stipulation and Agreement entered into by the parties to the TAPS rate case on February 11, 1982, ("Exhibit A" hereto). And provided further that this paragraph shall not extend to the rights and responsibilities of the settling parties under the Final Judgment entered in United States v. Atlantic Refining Co., et al., Civil Action No. 14060 (D.D.C. December 23, 1941).

D.4 Phase I Settlement - Each settling party agrees to dismiss its claims in Phase I of the TAPS rate case, without prejudice to its rights to reassert those claims at the termination of the Settlement for the period following said termination.

D.5 Phase II Settlement - The State agrees to withdraw, with prejudice, its cost of construction claims in Phase II of the TAPS rate case. The State further agrees to dismiss its other claims in Phase II of the TAPS rate case, but without prejudice to its rights to reassert those other claims at the termination of the Settlement for the period following said termination. Each settling TAPS owner agrees

to write down, on December 31, 1984, the amount recorded for pipe line construction costs in carrier property accounts 030, 155 of the Uniform Systems of Accounts Prescribed for Oil Pipeline Companies Subject to the Provisions of the Interstate Commerce Act, 18 CFR Part 352, or its successor, by its proportional share of \$500 million, and to reflect that writedown in the first Annual Report, Federal Energy Regulatory Commission, Form P it files with the FERC, and equivalent form it files with the APUC, after December 31, 1984, by writing down, by its proportional share of \$500 million, the amount recorded in account 030, 155 on Form P Carrier Property Schedule 230 and Form P Depreciable Carrier Property Schedule 231. If this Settlement Agreement is joined by all TAPS owners within 90 days of the Effective Date, each TAPS owner's obligation under this paragraph shall be deemed satisfied if it writes down carrier property accounts 030, 155 by its proportional share of \$400 million on December 31, 1984, and reflects this writedown in filings with the FERC and APUC as described above.

D.6 Dismantling, Removal, and Restoration - In accounting for the obligation imposed on it by Stipulation 1.10 Completion of Use in the Agreement and Grant of Right-of-Way for Trans-Alaska Pipeline (January 23, 1974), each settling owner shall, on the termination date of this Agreement, have accrued no less than 1/365th of the amount provided in Schedule A, line 9 of

the TAPS Initial Decision (February 1, 1980) for each day from the date each settling owner commenced accruing removal and restoration charges through the day prior to the termination date.

D.7 Depreciation - In accounting for depreciation during the term of this Agreement, the settling owners agree that they shall abide by the terms, conditions and schedules of the Stipulation and Agreement entered into by the parties to the TAPS rate case on February 11, 1982, ("Exhibit A" hereto).

D.8 Implementation

No later than the next business day following the day that this Agreement is filed with the FERC, each settling owner shall have filed, and used its best efforts to put into immediate effect, a tariff of not more than \$5.50 per barrel or its present tariff rate, whichever is less, for shipments of Sadlerochit petroleum through TAPS. Each settling owner shall utilize its best efforts to assure that it puts into effect a tariff that complies with paragraph C.1 of this Agreement for petroleum shipped through TAPS at the earliest possible date, and in no event later than 5 business days, after the Effective Date. Subsequent adjustments shall be made once each year, and shall go into effect for petroleum shipped through TAPS within 60 days of the anniversary of the Effective Date.

If no protests are filed to the Settlement Agreement, this Agreement shall be null and void and of no further force and effect unless the Commission approves the Agreement in an order acceptable to all of the settling parties within 60 days of the date on which the Agreement is filed with the FERC. If any protests are filed to the Agreement, the Agreement shall be null and void and of no further force and effect unless the Commission approves the Agreement in an order acceptable to all of the settling parties within 90 days after the Settlement is filed with the Commission, or on or before January 1, 1983, whichever first occurs. The settling parties agree that an order will not be deemed acceptable unless it dismisses each settling owner from Phases I and II of the TAPS rate case. If an FERC order approving this Agreement is appealed, and as a consequence of such appeal is reversed or vacated (in whole or in substantial part) by a court of competent jurisdiction, then upon issuance of the court's mandate this Agreement shall become null and void and of no further force and effect.

D.9 Index Substitution - In the event that the Bureau of Economic Analysis of the United States Department of Commerce, or any successor thereto, ceases to publish the Index or substantially changes the publication frequency, composition or construction of the Index, the settling parties shall promptly agree upon a substitute index for use in the implementation of this Agreement.

D.10 Enforceability - The settling parties agree that if, at any time during the term of this Agreement, TAPS tariffs are no longer subject to Federal or state regulation, this Agreement shall be deemed a binding contract among them. It shall in that event be governed by and construed in accordance with the law of the State of Alaska, and shall be enforceable in an action for specific performance brought in Alaska Superior Court (or any successor thereto) in Anchorage, Alaska. The settling parties hereby consent to the jurisdiction of said court.

D.11 Extraordinary Changes in Throughput - This Agreement shall become null and void and of no further force and effect if annual throughput falls below 219 million barrels during any twelve month period for any reason other than the occurrence of an Extraordinary Event, or exceeds 730 million barrels during any twelve month period because of additions of pipe or pumping equipment to the System beyond that contemplated by the original TAPS design, i.e. one 48 inch pipeline and 12 pump stations with 3 pumps operating at each station.

D.12 Entire Agreement - This Agreement embodies the entire agreement and understanding between the settling parties and supersedes all prior agreements and understandings relating to the subject matter hereof not specifically referred to herein.

D.13 No Waiver - No failure to exercise, and no delay in exercising any right, power or remedy hereunder or under any document delivered pursuant hereto shall impair any right, power or remedy which a settling party may have, nor shall any such delay be construed to be a waiver of any of such rights, powers or remedies, or an acquiescence in any breach or default under this Agreement of any document delivered pursuant hereto, nor shall any waiver of any breach or default of a settling party hereunder be deemed a waiver of any default or breach subsequently occurring. The rights and remedies herein specified are cumulative and not exclusive of any rights or remedies which a settling party would otherwise have.

D.14 Notices. All notices, requests, consents and demands hereunder shall be effective when duly deposited in the mails, certified mail, return receipt requested, or transmitted by telex, addressed to the respective party at the address set forth below.

State of Alaska: Attorney General
State of Alaska
Department of Law
Pouch K, State Capitol
Juneau, Alaska 99811

BP Pipelines Inc.: President
BP Pipelines Inc.
620 Fifth Avenue
New York, NY 10020

Any of the above may change such address by notice in writing given to the other parties to this Agreement.

D.15 Successors and Assigns - This Agreement shall be binding upon and inure to the benefit of the settling parties and their respective successors and assigns.

D.16 Counterparts - This Agreement may be executed in any number of counterparts, all of which taken together shall constitute one agreement, and any settling party may execute this Agreement by signing any such counterpart.

D.17 Amendment and Waiver - Neither this Agreement nor any provisions hereof may be changed, waived, discharged or terminated orally, but only by an instrument in writing signed by the party against whom enforcement of the change, waiver, discharge or termination is sought.

MEMORANDUM

State of Alaska

CONFIDENTIAL - ADVICE OF COUNSEL

TO: To The File

DATE: March 1, 1982

FILE NO:

TELEPHONE NO:

FROM: Wilson L. Condon
Attorney General

SUBJECT: Status Report

TAPS STATUS REPORT

1. Breakdown of Expenditures.

The TAPS litigation has been staggered into 2 phases by the Federal Energy Regulatory Commission (FERC). Phase I addressed the general methodology question: What formula should be used to set tariff rates for oil pipelines in general and for TAPS in particular. Phase II will address the specific questions of what actual dollar amounts should be plugged into the formula developed in Phase I.

The biggest single issue in Phase II focuses on the level of wasteful or imprudent expenditures Alyeska ran up in the construction of TAPS. This has become known as the "cost of construction" case. The remaining issues in Phase II have been clustered together and have become known as the "cost of service" case.

The following table breaks down the actual and projected expenditures associated with each Phase of the case.

TAPS Expenditures -- Historical and Projected
(Rounded to nearest thousand)
(000 omitted)

	Phase I (including settlement efforts and APC appeal)	Phase II Cost of Construction	Cost of Service	Department of Law Administrative
Actual Ex- penditures to date (FY 77 - to mid FY 82)	3,916	12,175	1,275	300
Projected Ex- penditures for balance of litigation ef- fort (mid- FY 82 to end of FY 87)	460	11,920	3,070	675
Totals	4,376	24,095	4,345	975

Overall grand total of actual plus projected expenditures =
\$33,791,000.

2. What remains to be done.

Phase I. The administrative record is complete. The Administrative Law Judge adopted almost all of the position advocated by the State. This decision now must be defended in appeal proceedings first before the FERC and then before the courts.

Phase II.

Cost of Construction. All pre-trial work has been substantially completed. Cross-examination of witnesses commenced on 2-24-82. When cross-examination of our witnesses is completed, we will have to cross-examine the owner companies' witnesses and present our rebuttal case. Next, briefs will have to be submitted to the FERC. Lastly, appellate work will probably be required, either to defend our victories or to reverse any unfavorable decision.

Cross-examination, at least of our witnesses, is expected to take an enormous amount of time. The owner companies have notified us that they expect to cross-examine our first witness alone for at least 8 weeks. We have a total of 30 witnesses. In recognition of the time and expense of the cross-examination hearings, the Phase II budgets reflect nearly as much money to complete the cost of construction and cost of service cases as was required to do all of the case preparation.

Cost of Service. Pre-trial work is nearly complete. Final drafts of written direct testimonies and related exhibits are in production and will be filed on 3-12-82. What will then remain is cross-examination of our witnesses and their witnesses, presentation of our rebuttal case, briefing, and whatever appellate work may be required.

3. Options in lieu of full-scale litigation with outside counsel.

As alternatives to continued full-scale litigation with outside counsel, the Department has considered:

- (1) Settlement;
- (2) Reduction in scope of case; and
- (3) Increased involvement of Attorney General's office.

Settlement. General settlement discussions between the State and representatives of the four major TAPS owners have been going on for nearly a year. At this point settlement appears more likely than ever before, but still less than a 50% probability. Within the past month, ARCO, Exxon and Sohio rejected the State's most recent settlement proposal. To date they have not made any counter-offers of their own. House Counsel for B.P. has indicated his willingness to recommend to his management settling at a 1982 tariff of \$4.625, 40% of which would escalate at the rate of inflation for the next 10 years. It is presently unclear whether such a proposal would be acceptable to the Legislature, assuming it might be acceptable to the Governor. It is also unclear what effect a separate settlement with B.P. would have on continued litigation with the others.

Reduction In Scope of Case. The State would not benefit enough to justify abandoning either or both Phase II cases. On the plus side, the State could save a projected \$12 million by abandoning the cost of construction case and/or a projected \$3 million by abandoning the cost of service case. On the minus side, this would mean throwing away \$12.2 million that has been spent to prepare the cost of construction case and/or \$1.3 million that has been spent to prepare the cost of service case.

The State would also lose the rate-reducing value of either or both cases. The cost of construction case has 4 times the dollars-and-cents potential of the cost of service case, but the cost of service case raises more traditional issues that have a greater likelihood of being fully successful. Consequently the return on each dollar of litigation investment is about the same for each case.

It may be possible to negotiate a partial settlement on some or all of the issues raised in the cost of construction and cost of service cases. However, voluntarily scaling down now would seriously impair the State's negotiating position in any such settlement discussions.

If the legislature is unwilling to fund full-scale efforts for fiscal 1983, a more cost-effective alternative to terminating either Phase II case would be to fund full-scale efforts for the first three quarters of the fiscal year. Funding for the last quarter could then be reserved pending an examination of progress achieved in settlement negotiations and/or the hearings through 3-31-83.

Increased Involvement of Attorney General's Office. The State would probably not save enough to justify increasing the involvement of the AGO. The logical areas for the AGO to assume responsibility are briefing and appellate work. Allowing for the huge size of the administrative record, the Department of Law would need to be increased by 3 to 5 attorneys plus related secretarial, clerical and administrative personnel. Since most if not all of the appellate work requires a Washington, D.C. presence, any special TAPS section should be officed in Washington.

There is certainly room for savings using in-house personnel. Current budget projections estimate \$4.8 million as the cost of briefing and appeal using outside counsel, who presently bill at an average rate of \$125 per hour. AGO attorneys cost far less per hour and typically perform work of a quality equal to the best the private bar can offer.

But the attorneys who built the TAPS trial record should be able to handle the briefing and appellate work with greater speed and authority than attorneys who come to the record cold. They are already located in Washington D.C. with facilities and support personnel in place. And they can readily and easily be terminated if we settle during the appellate process.



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

January 28, 1982

The Honorable Wilson L. Condon
Attorney General
State of Alaska
Pouch K
Juneau, AK 99811

Dear Wilson:

This letter follows upon our conference of Monday afternoon, January 25, 1982, during which we discussed the current status of your ongoing TAPS settlement discussions with B.P. Pipeline Company. I understand from you that the other major TAPS owner companies -- ARCO, Exxon, Sohio -- have not shown any interest in negotiating on any basis which might be acceptable to the State. Accordingly, if negotiation efforts are to continue, for the time being at least they will have to proceed only with B.P.

You have reported B.P.'s counter-proposal of a 1982 tariff of \$4.75 per barrel, 40 percent of which would escalate with the rate of inflation. I understand from you that, under an assumption of 8 percent annual inflation continuing over the next 10 years, this counter-proposal is the equivalent of an average tariff rate of \$3.90 expressed in 1982 dollars. I further understand that this figure is somewhat above the \$3.70 target I tentatively set for you in my authorization letter of December 9, 1981, but that it reflects major concessions from B.P.

In order that settlement discussions may continue, you have asked for my authorization to make a counter-offer to B.P. and for some additional room within which to negotiate. Based on your recommendations, which have been seconded by my advisors and by Commissioner Williams, I authorize you to make the following counter-offer to B.P.: a 1982 tariff of \$4.35 per barrel, 40 percent of which would escalate with the rate of inflation. I understand that, keyed to the 8 percent inflation assumption, this is the equivalent of a 10-year

January 28, 1982

average tariff rate of \$3.58 expressed in 1982 dollars. You are further authorized to represent my willingness to recommend to the Legislature a settlement as high as \$4.45 per barrel for 1982, 40 percent of which would escalate with the rate of inflation. This I understand to be the 10-year average equivalent of \$3.66.

As before, I reserve my full rights, powers and intent to confer with State legislative leaders and my advisors within the Executive Branch and the Governor's office before finally committing to any settlement proposal. Although I may have the power to irrevocably commit the State to a settlement figure on my own authority, it is my present intent and desire not to do so until I have conferred with legislative leadership and have at least received their reactions to any settlement proposal that is both acceptable to B.P. as well as provisionally acceptable to me.

Thank you for another informative briefing.

Sincerely,


Jay Hammond
Governor

RECEIVED
Department of Law
Juneau, Alaska

AM FEB 02 1982 PM
7,8,9,10,11,12,1,2,3,4,5,6



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

December 9, 1981

Wilson L. Condon
Attorney General
State of Alaska
Pouch K
Juneau, AK 99811

RECEIVED
Department of Law
Juneau, Alaska
DEC 16 1981
AM 2:18 PM
DEC 16 1981

Dear Wilson:

This letter follows upon our conference of Tuesday afternoon, December 8, 1981, during which we discussed the current status of the TAPS litigation before the Federal Energy Regulatory Commission and your recommendations regarding our entering settlement negotiations with the pipeline owner companies. In preparation for that conference my staff and I have read your comprehensive 92 page Briefing Paper dated November 23, 1981, including the supplemental tables attached to it.

Based on the considerations you have discussed in the Briefing Paper and your judgments (shown on the tables) as to the likely outcomes of pursuing the administrative process to its conclusion, I am in agreement with you and expressions from the legislature that the State would be well-advised to settle the TAPS litigation if it can do so on an advantageous basis. Accordingly, I hereby give you the following authority to pursue negotiations with the pipeline owner companies and any other parties to the proceedings:

As per the recommendation of yourself and Commissioners Katz and Williams, you are expressly authorized to advance a settlement proposal to the pipeline companies of a \$4.11 tariff rate commencing on January 1, 1982, and continuing for the next 10 years until December 31, 1991. Furthermore, 20% of this \$4.11 figure would be allowed to escalate year-by-year at the actually experienced rate of inflation. I understand from you that, under an assumption of 8% annual inflation continuing over the next 10 years, this authorized settlement offer is the equivalent of an average tariff rate of \$3.17 expressed in 1982 dollars.

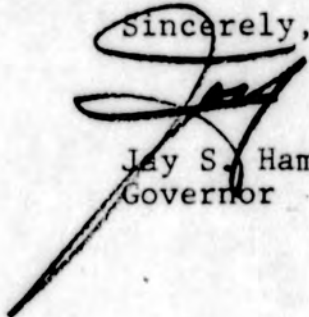
I also understand that you do not anticipate that this offer will be acceptable to the pipeline companies, but rather you see it as merely a step to move the negotiating process along. After you make this \$4.11 offer any further firm

December 9, 1981

offers or counter offers you may wish to make must be made with my expressed approval. Based on your written presentation and our discussions to date, I am tentatively setting as your negotiating goal a 10 year settlement not to exceed the equivalent of an average rate of \$3.70 expressed in 1982 dollars and premised on an 8% inflation assumption. You understand that my expression of this negotiating goal is not a present commitment by me to accept such a figure as a settlement in the event the companies should be amenable to such a figure. I reserve my full rights, powers and intent to confer with State legislative leaders and my advisers within the Executive Branch and the Governor's Office before committing to any final settlement proposal other than the one specifically authorized by this letter.

Thank you for the detailed briefing you have given me, and good luck with the ensuing negotiations.

Sincerely,



Jay S. Hammond
Governor

SCOMM

28:8

1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE
2 JOINT GAS PIPELINE FINANCING COMMITTEE
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6 TRANSCRIPT OF PROCEEDINGS
7 MAY 20, 1981
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*Continues
May
20, 26,
1981*

16 COMMITTEE PRESENT:

17 Representative Terry Gardiner, Chairman
18 Senator Michael Colletta
19 Senator Bettye Fahrenkamp
20 Senator John Sackett
21 Representative Hugh Malone
22 Representative Anthony Vaska
23 Representative Brian Rogers
24 Representative Joe Hayes
25 Representative Richard Randolph
Representative Sam Cotten

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P R O C E E D I N G S

5/20/81

MR. GARDINER:

... joint meeting of the House and Senate Gas Pipeline Financing Committee. The subject of today's meeting is to take testimony on Sponsor Substitute for House Bill 200. Commissioner Williams will be the first person to testify today. The Commissioner will probably go into it -- but this Sponsor Substitute was the Bill that is an outgrowth of the report that we reviewed at the last meeting that was prepared by the Committee and this Bill was drafted by the Commissioner with the other members of the Administration and the consultants that had worked on the previous report for the Legislature. So now I will turn it over to the Commissioner.

Commissioner Williams:

Thank you Mr. Chairman. I apologize to the members of the Committee for being just a little late finishing the last part of the presentation. For the record my name is Tom Williams and I'm Commissioner of Revenue. The Sponsor Substitute for H.B. 200 has been introduced by the Governor and obviously then I'm -- I support him. The -- this Bill is in response to -- or is an outgrowth of the joint meeting that was held earlier in the session between the Governor and the legislative leader-

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3 ship of both houses at which time the sentiment was expressed
4 that the state is currently taking a fair share of the gross
5 revenue from the oil resources of the state. Pursuant to that
6 agreement we have been looking to find ways to protect the
7 major revenue source that is currently supporting the state,
8 namely, the oil and gas corporate income tax. As I testified
9 earlier to this committee, when Mr. Messenger made the
10 presentation of his first report, there are two kinds of
11 risks involved here. First is the risk inherent in the size
12 of the share that we decide to take. That's approximately
13 30%. That, essentially, from our point of view, is a figure
14 that's been settled on. Our problem has been instead not to
15 eliminate that risk, since the only way we could eliminate
16 it is to take a smaller percentage. Rather, our task has been
17 how to eliminate any other extraneous risk from coming into
18 the source of revenue. With the oil and gas income tax there
19 is extraneous risk. Namely, since the time that tax was passed
20 in 1978, the Supreme Court has come out with a couple of
21 decisions that leave in question whether the method used to
22 determine taxable income on an oil and gas corporation is
23 permissible under the principles that the Court has set out
24 pursuant to the U.S. Constitution. Mr. Messenger's report,
25 in which I concurred, recommended that a reserves tax used as a

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3 back-up to the income tax had adequate revenue generation
4 potential.to protect the income stream that we are now
5 getting from the oil and gas corporate income tax.

6 If I may, Mr. Chairman, I'm going to get up from time to
7 time and walk over and show on the pictures that I've
8 rudely sketched out here. This is what we mean by the
9 backstop approach. I apologize for folks sitting next...
10 Right now, in red, this represents the income stream in a
11 year under AS 43.21, the oil and gas corporate income tax.
12 Now the original version of this bill, which the Governor
13 introduced, proposed to make certain technical changes to
14 clean up what we called warts in our case and hence the
15 term "warts" up here. There are technical changes to
16 -- they don't have major revenue consequences but they do
17 have inadvertent consequences that make for bad facts.
18 They weren't originally intended, I don't believe, when
19 the law was passed and so it's still by way of a clean up
20 measure. Also was the question of the windfall profits
21 tax and whether that should be allowed as a tax deduction.
22 As you recall, there was no such thing as a windfall
23 profits tax when -- it wasn't ever dreamed of at the time
24 that the original bill was drafted. Because it was so
25 finely drafted, there was no provision in there to allow

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3 that as a deduction, and to many this seems unfair
4 since it is in fact a cost that's associated with
5 oil and gas operations up here. So if we look at this
6 dotted area as being the amount of revenue represented
7 by the "warts" of the windfall profits tax. Then here
8 is the rest that will actually be paid under AS 43.21,
9 the oil and gas corporate income tax. This solid
10 area here. Backstopping this, if you will, is the
11 reserves tax. Mr. Messenger's report concluded, first,
12 that the overall size of the reserves tax would be
13 at least the same or on the same order of magnitude
14 as the overall size of the revenue that we are
15 collecting under the present version of AS 43.21.
16 That is, the amount they would pay plus the amount
17 of the "warts", and the amounts of the windfall profits
18 tax. The trick then is how to backstop this. Well,
19 it's really not that big a trick. The actual amount
20 that gets paid under 43.21, the net amount, is a
21 credit, dollar for dollar against the reserves tax
22 liability. So this portion of the reserves tax
23 amount is not in fact paid by the oil and gas
24 companies. This amount here is paid by the oil
25 industry under 43.21. The excess amount, the extra

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3 amount of reserves tax over and above the amount of the
4 credit is an actual liability. So they will pay this
5 portion of the reserves tax. When you add this
6 portion to this portion the sum is the same size
7 rectangle as you had with your original revenue
8 stream. And that in fact is what we were trying to
9 do -- we were trying to preserve the revenue stream
10 that we see under 43.21 as it is now before making
11 any "warts" corrections and before making any
12 allowance for the windfall profits tax. That was
13 the mission, that was the understanding we had --
14 that was the substance of the joint statement made
15 earlier in the session. So this is the basic
16 approach that the Committee Substitute now incor-
17 porates: a reserves tax with a credit for the
18 actual payments here and payment here to offset
19 the foregone income from the new deductions.
20 Now it is important to know how this works. In
21 the event that there is an adjustment in the amount
22 of tax actually paid - for instance, as the bill
23 provides, if for some reason 43.21 is declared
24 unconstitutional, or is stricken down for other
25 reasons, there is a provision in there that their

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3 liability in the industry will revert back to 43.20,
4 which is the standard, ordinary income tax. We
5 believe 43.20 is defective when it is applied to
6 extractive multi-state industries like oil and gas.
7 But it is possible that it could fall back to 43.20.
8 If it did this amount of payment would drop. And
9 the amount of credit, of course, correspondingly,
10 would drop so that the amount of actual liability
11 being paid under the reserves tax would increase
12 as the credit decreases. Thus, even if there is
13 a court decision against us, the mechanism is in
14 place with the passage of this bill to protect the
15 full amount here. Once again, you'll have some
16 sliver being paid under an income tax - you'll have
17 the remainder being paid under the reserves tax.
18 That's the basic approach, the basic idea behind the
19 backstop. Now what are the dollars and cents
20 effects. We have under -- we will retain some
21 consultants who work with the staff within the
22 Department of Revenue to project out. Naturally,
23 there's a lot of work involved in making a reserves
24 tax estimate because, since there aren't a lot of
25 sales and exchanges of fields like Prudhoe Bay,

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3 in fact it's unique, you have to approximate by
4 other methods what a willing buyer and a willing
5 seller would sell it for. This means projecting
6 forward the income stream, the gross income, the
7 operating costs, and discounting future income
8 to a present value. Of course, that basically
9 reflects the cost of money plus inflation with some
10 real return as a reward for risk plus inflation -
11 whatever it may be, but you have a discount factor
12 because a dollar one year from now is worth less
13 than a dollar today because I can invest the dollar
14 during that year. That's the basic idea of the
15 present value. This is the bottom line. We projected
16 with a high price assumption, which are optimistic -
17 they are reasonable but optimistic - and we projected
18 a low price case which is also reasonable and I would
19 not say is pessimistic either - I would say it is
20 simply conservative. This represents what happens
21 with the low price case. This is the bottom line
22 effect, if you will. In FY 82, with a 30 mill rate
23 as provided in the tax, you come out essentially a push,
24 \$7 million ahead, which statistically speaking given
25 the uncertainty is an insignificant difference.

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3 In FY 83 it's a modest decline of \$67 million. That is
4 to say, the reserves tax will fall short by about
5 \$67 million using a 25 mill rate from what the oil
6 and gas corporate income tax would have generated
7 before any "warts" were taken off or before the
8 windfall profits tax deduction was allowed. \$67 million
9 net change. Again, considering the fact that we are
10 talking about something well over a \$1 billion, a
11 \$67 million difference is small in the overall scale.
12 In fiscal year '84, again with a 25 mill rate, the
13 difference is \$49 million. Once again the
14 reserves tax would fall slightly short if it stayed
15 at the default rate of 25 mills. In both of these
16 years, these could be eliminated if one wished to
17 by slightly adjusting the millage rate. In fact, the
18 tax mechanism provides that the assessment -- the
19 preliminary assessment is to be done in October, the
20 final assessment, the certified amount, the assessed
21 value will be certified no later than February 1
22 which will give the legislature four weeks before
23 we have to start to get ready to mail out the tax
24 bills, in which to modify the tax rate so that if it
25 decides it doesn't want to leave this \$67 million, or

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3 if it doesn't want to leave this \$49 million, it can
4 nudge the rate up. Similarly, when we get to the
5 high price case you will see there will be possibilities
6 for nudging the rate down also. It can be adjusted
7 both ways, just by adjusting the millage. This is
8 exactly the way the property tax works here in the
9 municipality of Juneau. My property, my house, gets
10 assessed by the assessor and I have an opportunity
11 to protest my assessment, and then the municipal
12 finance committee decides how much money they need
13 and Harry Aase will work with the rest of
14 them and decide how many mills they need to generate
15 the revenue they want from that assessed value. They
16 then impose the levy. This is going to be the same
17 sort of mechanism. Unlike before, where the millage
18 rate was set in advance, the pressure was entirely
19 on the assessor. His decision determined what the
20 tax liability was going to be. Now he is freer to
21 come in with a real assessed value, what he believes
22 it to be, the legislature has ample time in which
23 to respond because, in fact, well before February 1
24 we will have a good idea what the assessed values
25 will be for all properties except for those that are

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3 under appeal. The total, by the way, as you can see
4 over a period, for the low price case, in this year we
5 dropped the millage down to 20 mills on the assumption
6 that there is a legislative policy of preserving
7 parity between the millage rate between the reserves
8 tax and the ad valorem tax on hardware, the equipment and the
9 pipeline and so on. That's been an assumption we've
10 made - it is not in fact in the statute, but the
11 legislature would be free to lower the millage to 20
12 mills and that's what would happen in this case. If,
13 on the other hand, the legislature kept the millage at
14 25 this would no longer be in the red. This would be
15 a black number showing a positive increase and the
16 total negative amount over a four year period would be
17 reduced. When we look at the high price case, we see,
18 first of all, that 30 mills offsets the income tax and
19 exceeds it by \$100 million. So if the assessed value
20 comes in by next January at the level indicated in the
21 preliminary analysis that we've done, and bear in mind
22 it could be higher or it could be lower depending on what
23 the market conditions are, but if it comes in at that
24 level, once again, the opportunity would exist for the
25 legislature to say "No, we didn't mean for this tax to

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3 increase the liability of the oil and gas industry, we
4 meant simply to preserve our revenues stream, our basic
5 revenue stream." And so the millage could be adjusted
6 down here perhaps to 29 or 28 and a fraction - whatever
7 it would take. This would be, once again, a push 0.
8 In fiscal year '83, dropping down to 25 mills, results
9 again practically in a push minus \$10 million.
10 Statistically that is too small to be significant. In
11 fiscal year '84 you can see what happens with a
12 continued 25 mill rate. The tax over generates, over
13 compensates, for the backstop by \$511 million.

14 MR. COTTEN:

15 What makes it go up right there? Do you anticipate
16 something that ...

17 COMMISSIONER WILLIAMS:

18 Well, it reflects the payoff of prior corporate
19 income tax credits. We have a credit mechanism, both
20 for current income taxes that they will be paying, plus
21 there is also the back taxes, \$1.5 billion that has been
22 paid in prior to this point. That is going to be allowed
23 as a credit against reserves tax liability. In the
24 first year that credit is not exhausted until very nearly
25 the end of fiscal year '84. In this year the credit

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3 in fact is used up in this year, and this anomaly
4 results in the fact that there is no more credit
5 available from the 1978-79-80 tax years. Depending
6 on how quickly the credit is used up one can adjust
7 the millage rate back down to restore the status quo.
8 Now, if the millage is lowered to 20 mills, again, if
9 this figure reflects 20 mills to simply be consistent
10 with the table preceeding it, you would be behind
11 again by \$118 million which shows that probably
12 something between 20 and 25, perhaps 22 or 21.5
13 mills would get this just about to zero again.
14 Using the same consistent assumptions we had in the
15 low price case, you can see that it could end up at as
16 much as a \$483 million gain over the four year period,
17 assuming there was no modification in the millage
18 rates whatsoever. This case is high - it is an
19 optimistic price case and given the way the world
20 looks right now I would have to say that the earlier
21 page looks more likely than this page, particularly
22 when you are getting out into this area because that's
23 when your assumptions or different assumptions have
24 had a chance to compound themselves for a couple of
25 years and the gap starts to widen between your

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3 assumptions. Let me just show you how, taking the
4 low price case, how we calculated those revenue effects.
5 I was giving you the bottom line. Now let's see
6 exactly how that bottom line was calculated. This is
7 the analysis of it with the low price case. This is
8 our present projection -- well, this is not an official
9 revenue forecast, this is what our consultants
10 developed for purposes of this analysis -- as a
11 projection of what the present oil and gas income tax
12 would have "warts" and all, no windfall profits tax
13 deduction, the present law as it is on the books.
14 You can see it is \$1142 million in fiscal year '82,
15 \$1356 million in '83, \$1474 million in '84 and
16 \$1585 million in '85. This is the target, this is
17 the income stream that we are going to try to match
18 with a reserves tax.

19 MR. ROGERS:

20 Tom, does that differ very significantly from you
21 revenue projections in-house.

22 COMMISSIONER WILLIAMS:

23 Ours would be slightly higher than this. We are still
24 waiting for the OPEC meeting which I think is next week.
25 We will be in a much better position if there are

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3 any announcements about production rates or price
4 increases at that time to be able to answer that.
5 This is how it is, the oil and gas corporate income
6 tax, as it is written right now. This is what we came
7 up with as what it would generate under the bill.
8 You would allow the windfall profits tax, you allow
9 the "warts", and for any uncredited reserves tax that
10 they actually paid, that would be a cost too, and that
11 would be a deduction as well. The new income tax
12 would be down, you can see, quite a lot from \$1142 down
13 to \$787, from \$1356 down to \$860 you can see as it goes
14 through time. Very significant drops in the income
15 tax by allowing these deductions. However, the new
16 reserves tax would be \$600 million in the first year,
17 then dropping reflecting the lower millage rate, to
18 \$429 million, rising with the same millage rate. Now
19 some people will say "Now why does that happen? We're
20 getting closer to the decline in the Prudhoe Bay curve
21 Why is that happening?" It's because you are also getting
22 closer to the phase-out of the windfall profits tax
23 under present law. A phase-out of the windfall profits
24 tax has a larger impact on the present value of the
25 income stream than the approach of the decline of the curve.

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3 This one would increase still more -- I'm sorry, this
4 one would increase still more -- but this is figured
5 at 20 mills. It would be larger if you were at 25.
6 The retroactive application of the "warts", that is,
7 allowing the cap to be removed on interest and so on
8 that was in the original version of H.B. 200. That
9 would apply retroactively to tax year '78-79 and '80.
10 It would show up as a revenue effect probably in fiscal
11 year '82, just given the nature of things. So that is
12 minus \$83 million. We have forecasted a lower effect
13 due to the removal of the interest ceiling in the
14 original fiscal note. That one assumed
15 \$50 million in the current year, rising by 10% a year
16 thereafter. That represents the extreme worst possible
17 case. We believe that it is much more likely that the
18 effect of that will be half that amount - \$25 million,
19 rising by 10% a year. This reflects that lower level
20 of removing that particular "wart". The retroactive
21 application of the windfall profits tax is estimated to
22 be \$156 million, \$3.3 million from the fiscal year 1979,
23 the remainder, \$153 million, from fiscal year 1980, tax
24 year '80 rather. These would be recognized in fiscal
25 year 1982 which would mean shortly after the 1st of July.

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3 The net cash flow, the new cash flow, that we would have
4 under the bill is, of course, adding these four numbers
5 together. It comes out to \$1149 million. \$1149 is
6 \$7 million larger than the \$1142 million we were trying
7 to match. And there we get \$7 million, and if we
8 put back \$2 million -- you will recall that was
9 exactly what I said was the revenue change. This is
10 the bottom line number -- what does the bill do to
11 revenues. In fiscal year '83 you add the numbers up --
12 of course, there is no more retroactive "warts" or
13 windfall profits tax being taken - that was all taken
14 in the first year so those are zero in '83 and thereafter.
15 You basically are then looking at the new reserves tax and the
16 new income tax combined, what the net payments are under
17 those. You can see that this comes out at \$67 million
18 less, \$1289 from \$1356 million, \$49 million less in
19 '84, and \$55 million less in 1985. Time did not allow
20 me to prepare a similar table in this format -- on the
21 next pages where it would have been is blank -- that
22 would have been for the high case. But there just
23 wasn't time before the hearing started. The high case
24 has a similar analysis that leads to the bottom line
25 that I presented to you earlier. I can make that available,

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3 of course. Copies of this analysis can be made available
4 as soon as the hearing lets out and we will mail them
5 to members of the Committee. So much for the dollars and
6 cents right now. I'd like, if I may, Mr. Chairman, to talk
7 a little about some of the policy questions here and some
8 of the particular provisions involved in the bill. Most
9 particularly, I think it is important to look on pages
10 6, 7, and 8 - the findings and purposes that would be
11 codified in the reserves tax chapter. I think that
12 these are probably all familiar to all of you. However,
13 just for the sake of the record, I will run through
14 them because I think it is important that everyone under-
15 stand what the justifications are for this action.
16 The first finding is that since statehood the level of
17 services and facilities available to the public the state
18 has been able to provide has been below that that other
19 states have been able to provide. The reason is that
20 Alaska has never had as much money, not enough money
21 to provide it. Second, even today there are inadequate
22 facilities, which people may reasonably expect, are
23 inadequate in comparison with other states. These include,
24 and it is not an exhaustive list, public transportation --
25 all you have to do is try to drive to Juneau or all you

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3 have to do is try to drive to Nome for that matter, or
4 try to drive out to southwestern Alaska - you can't do
5 it. You can't take the train. Oftentimes you can't fly
6 because the airport may not be up to standard, or it may
7 be dangerous to do so. Inadequate public health care
8 facilities. I remember the time I was in Fort Yukon and
9 a person there had been shot and was waiting two days
10 for the plane to get in so they could get hospitalization.
11 That hasn't changed. There are still problems out there.
12 Inadequate communications facilities. Anybody try dialing
13 out of 465 number in the past few days - except at lunch
14 hour it's hard to get an outside line for long distance.
15 Inadequate public education facilities - that's something
16 that we've been working on. The so-called Molly Hootch
17 schools. But they are not all built. The problem is not
18 just in the rural areas. There is a tremendous amount
19 that remains to be done in public education. Inadequate
20 levels of police protection. A state this size and the
21 size of the police and fire that we have - it's an
22 impossible task to provide the same degree of protection
23 and coverage and service as other states can. Overburdened
24 justice facilities - I think the Chief Justice in his
25 speech State of Judiciary has shown there has been progress

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3 there, but there still remains a problem. Inadequate
4 energy facilities, of course, there's alternative
5 energy sources that are sustainable such as wind, and
6 also hydro. It's incredible that our two largest
7 population centers are not linked together in an energy
8 grid. That's something that everybody in the lower 48
9 takes as granted. The entire east coast is linked in an
10 energy grid. Finally, an economy overly dependent on
11 non-renewable resource development. Well, that speaks
12 for itself. Will we or nil we, we are producing an
13 extremely valuable resource belonging to the state and
14 it's such a large resource and such a valuable resource
15 that it is more than 90% of the total amount of money
16 that state is receiving. It is important, since this
17 resource is a one-time-only resource, that we prepare
18 for the day when it begins to be exhausted, that
19 production rates can no longer be sustained and that
20 other sources of revenue and other sources of economic
21 activity be in place at that time. This is critical -
22 without that we are doomed. As all of you know, as I
23 said in the beginning of my remarks, one of the reasons
24 that has stimulated us to do the analysis we have done
25 and carry on this project is the litigation that raises

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3 a substantial question. I believe we will win. But I
4 also believe that we should not play craps with \$9 billion.
5 Even if we had a 90% or 95% chance of winning, the
6 consequences are too severe if we should happen to crap
7 out. There is really no other activity up here that could
8 sustain the major portion of the revenues that we need
9 to protect. By far our largest industry and our most
10 valued industry is the petroleum industry. They are the
11 source of the revenues that we are seeing now. If we were
12 to attempt to backstop the oil industry's income tax by
13 imposing taxes on timber or on fisheries or on mining or
14 on any other activity up here, tourism, if we were to do it
15 on all of them together we couldn't begin to approach
16 the amount of revenues that in fact we need to backstop.
17 Consequently, that is really not a viable alternative
18 that is open to us at this time. We also have seen that
19 the present level of taxation on the industry is not so
20 onerous that the industry has abandoned hope on Alaska.
21 We have seen active bids just two weeks ago or in the
22 last two weeks in the north Cook Inlet. We earlier saw
23 major interest in a Beaufort Sea sale. The point is,
24 where the resources are there will be interest if you don't
25 get to the point of being confiscatory. This tax was in

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3 place - people knew what those costs are and still they
4 were willing to bid as high as 79% of the net profits
5 from the lease and pay a 20% royalty and pay a fixed
6 bonus in the millions of dollars for a given tract.
7 I think that speaks for itself. We have not totally
8 discouraged industry - in fact, that we still provide,
9 of the major areas of the world, perhaps the most
10 hospitable rather than hostile economic climate, other
11 than of course our physical climate which we can do
12 nothing about. One of the problems that does exist,
13 I think, is that we find in the two areas where we do
14 have significant amounts of proven gas reserves, it is
15 very difficult to develop a market for natural gas.
16 The pipeline, of course, is -- the financing is in
17 difficulty, there's talk of decontrol and the cost of
18 the pipeline are such that there will be very little
19 wellhead value perhaps after the costs of transportation
20 are deducted from the price when it is delivered to
21 market. To oppose the reserve tax at this time makes
22 the economic development of those gas reserves even
23 more marginal. In the Cook Inlet we also see
24 substantial quantities of gas known to exist, yet, the
25 Pacific-Alaska LNG project has been on the boards for years

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3 and is still tied up, partly in litigation, but also
4 there are questions about the adequacy of the reserves
5 to cover it and there are problems with the basic
6 economics of the project. To include a reserves tax on that
7 could jeopardize a project. It could also jeopardize
8 the development of the natural resource there for other
9 economic activity since the fields do seem to be so
10 marginal or they would have been developed by this time -
11 to impose a reserves tax on that may well jeopardize
12 their viability and consequently this bill does
13 provide for an exemption of reserves from the reserves --
14 gas reserves, I mean, from the ad valorem tax on the
15 reserves. Finally, we get to a question of lands that
16 are received by regional corporations under the Alaska
17 Native Claims Settlement Act. This is probably the most
18 difficult aspect of this Sponsor Substitute bill to
19 understand at first sight and once again I have a little
20 chart which shows what happens with the money that
21 native corporations receive from lands that it has
22 obtained under the Alaska Native Claims Settlement Act.
23 Those are supposed to be oil wells. This is ANCSA land -
24 Alaska Native Claims Settlement Act lands. The income
25 comes into the regional corporation that owns it. 70%

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3 of the income that comes in to the regional corporation
4 is required to be shared under the provisions of
5 section 7(i) of the Native Claims Settlement Act.
6 That is an absolute condition, it is an absolute
7 obligation of the native corporation, the native regional
8 corporation to pay and to share. This sharing then goes
9 among all 12 of the original regional corporations on the
10 basis of the number of shareholders they have. I didn't
11 draw twelve circles here but you can easily see the idea -
12 the money goes back to all twelve regions, including
13 the original region. Under other subsections of section
14 7, each region is in turn required to share one half
15 of the amount it gets here - it is supposed to divide
16 that one half among the village corporations that it has.
17 The village corporations in turn can pass that on to
18 their shareholders. One of the questions is, how should
19 this type of income, which is in black, be treated under
20 the oil and gas income tax, or how should income tax be
21 applied to it. Clearly, this part, which is in red, falls
22 within the purview of AS 43.21, the oil and gas corporate
23 income tax and the regional corporation or its subsidiary
24 that holds the mineral interest in this land is the tax-
25 payer under AS 43.21. It is under 43.21. Since it is

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3 statutorily obligated to distribute 70% of the money
4 that comes in, the bill provides for recognition of
5 that fact and allows them to deduct the 70% in fact
6 that it is distributing. 30% remains with them and
7 that will be taxable to them under 43.21. What about
8 the shared income? Should all these regions and all
9 their respective village corporations be under 43.21
10 or should they be under 43.20? There is no difference
11 in terms of the amount of tax they are going to pay.
12 They are all Alaskan corporations so all of them are
13 going to be paying the full 9.4% rate except on the
14 first \$50,000 of course, that is 5.4%. They are going
15 to pay the same rate as oil companies do - and as this
16 regional corporation does on its 30% that it retains --
17 it is 9.4%. The question basically is going to be,
18 should 200 or so village and regional corporations have
19 to fill out the 75 page form with all sorts of information
20 about production costs, depreciation, and intangible
21 drilling costs, capitalized interest and everything else
22 which they know nothing about - all they know is they
23 are getting money out of this pool. That is all they see.
24 They can fill all that out and put in zeros, or they can
25 fill out the simple, regular corporate tax return. Their

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3 liability is going to be the same on this income that
4 they get. Absolutely the same. Rather than put them
5 to that inconvenience, rather than go through such an
6 elaborate application of 43.21, the Sponsor Substitute
7 suggests drawing the line here. The area in red is
8 oil and gas related -- it is chapter 21. Income to
9 the region owning the land is 43.21 income. The
10 disbursement from the region into the sharing pool
11 is deductions under 43.21. But for the recipients
12 of the shared income, whether they are regions or
13 they are villagers, it is regular income since they
14 are going to pay the same amount of tax. It is not
15 going to put them to all the hassle of filling out
16 the elaborate forms and complying with, Lord knows,
17 how much more complicated regulation there seems to
18 be. Regulations are not complicated - in fact, for
19 these people because they're just receiving it. Regulations are
20 complicated only when you've got a direct interest in oil and gas production.
21 We think that makes sense. Therefore, when you get to
22 the very first section of the bill -- on page one,
23 starting on line -- well, I guess it is line 17 --
24 17 and a half -- the underlined portion there, income
25 from sharing in the 70% of a native regional corporation's

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3 revenue that is required to be divided under section 7(i)
4 of the Native Claims Settlement Act is taxable income
5 under this chapter, meaning 43.20. That's just what I
6 was describing - that says, the lines in black there,
7 the income represented by the black lines, black arrows,
8 on that chart, is going to be 43.20 income. Still taxed
9 at the same rate but 43.20. For the corporation that is
10 the regional corporation, for the 30% that it retains,
11 it is going to be taxed under 43.21, just the same as
12 an oil company. And that's how that works. If I may,
13 I'd like to run briefly through, section by section
14 briefly, summarizing what the effects will be of the
15 various provisions. I have already covered some of them.
16 I don't believe this will take more than 10 minutes to
17 run through section by section. The first section, of
18 course, includes what I just was talking about - the
19 treatment of the income that is shared, the section 7(i)
20 shared income. In addition, it just makes some
21 technical changes earlier in the provision of 43.20.011(e)
22 to make it parallel and consistent with the corresponding
23 provisions regarding the application of chapter 21.

24 MR. GARDINER:

25 Tom, I have one question here where it sets a rate. I was

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3 wondering on other jurisdictions which have ad valorem
4 taxes - we already have one on the (indisc.), I guess.
5 Do any of those jurisdictions administer -- like
6 municipalities administer property taxes in the state --
7 setting a millage rate annually?

8 COMMISSIONER WILLIAMS:

9 Yes. Most jurisdictions, in fact, -- well, most
10 jurisdictions that I'm familiar with anyway, find out
11 what the assessment roll is and determine how much
12 revenue they wish to collect in order to implement the
13 various programs they have and then factor the millage
14 and impose the millage each year that produces the
15 desired amount of income from the ad valorem tax.
16 They are, of course, tempered by the fact that if they
17 impose it too high they may face a recall or they may
18 lose in a later election.

19 MR. GARDINER:

20 But earlier you explained they way it is scheduled is
21 that even if though this does not provide a mechanism
22 whereby the legislature annually sets it because of the
23 time frame when it is imposed. We, in effect, could
24 each year, as the legislature met, if our predictions are off,
25 we could raise or lower it ...

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3 COMMISSIONER WILLIAMS:

4 Yes. You could and you should review it. The point
5 is that in the event that you fail to take action rather
6 than have no rate for that year, the statute contemplates
7 having a particular rate. That's what the rate is
8 unless you act.

9 MR. MALONE:

10 Let me -- the current ad valorem hardware tax -- we don't
11 have that provision that unless a different rate is
12 enacted ...

13 COMMISSIONER WILLIAMS:

14 That is correct. And that's, Mr. Chairman, one of the
15 problems with the administration of the ad valorem tax.
16 It means the last element of the calculation is the assessor's
17 opinion about what the value is of the property. Where
18 you have property regularly being sold, bought and sold
19 of like types, then that's no problem. But what is the
20 value of the Trans-Alaska pipeline system. No interest
21 in that has been sold. None has been offered for sale
22 recently. No one has offered to buy it recently.
23 There is not anything in the world comparable to it.
24 Therefore, there is a lot of pressure there because there
25 is a fairly broad range of subjectivity that the assessor

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3 has to apply his discretion in coming up with the
4 assessed value of the Trans-Alaska pipeline. When he
5 is providing the last element to the equation and he
6 can see for every million dollars or 10 million dollars
7 of assessed value he puts on, that results in a direct
8 dollar for dollar increase 2% of the amount of assessment.
9 Two cents on every dollar that he placed, that is 2 cents
10 more that is going to be paid. It naturally tempers and
11 has an influence, not only because -- well, primarily
12 because the assessor is also responsible for presenting to
13 you projections about what he thinks the tax is going
14 to bring in. He is not going to do it just for the current
15 year - he has to do it for next year and the year after
16 as well. When we fall short by \$160 million, there's
17 trouble. This time it didn't happen with property tax.
18 But the same sort of pressure is there on the assessor.

19 MS. FAHRENKAMP:

20 Mr. Chairman, I was curious, since we are going through
21 an analysis and many of us have committee meetings
22 in five minutes, we will have question time tomorrow?

23 MR. GARDINER:

24 Yes, if we don't finish and people have questions
25 tomorrow should -- the Commissioner will be available tomorrow,

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I think ... I didn't ask him ...

MS. FAHRENKAMP:

I beg your pardon, if we don't finish ...

MR. GARDINER:

Are you going to be available tomorrow?

COMMISSIONER WILLIAMS:

I certainly plan to be.

MR. GARDINER:

If we have questions that we don't finish today we will start off with those tomorrow.

MS. FAHRENKAMP:

Obviously, there can be no finishing of questions with five minutes left.

MR. GARDINER:

Yes. We can continue tomorrow. Representative Rogers.

MR. ROGERS:

Your suggestion of the annual -- the legislature annually setting a rate based on trying to get it to come out equivalent to the 43.21. That assumes the Department of Revenue would continue to calculate what the old 43.21 would have brought in and adjust it to that level. I wonder if future legislatures would use the old 43.21 as a yardstick. It seems to me that is one problem perhaps

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3 in assuming that 1984 or 1985 reduction of 20 mills. It
4 assumes that we are going to sit down and say, Gee, What
5 were we going to get under that old tax we had five years
6 ago?

7 COMMISSIONER WILLIAMS:

8 It won't be very hard to calculate at all because we know
9 what the gross production income is. Each one of the
10 "warts" that is representing a deduction will be a
11 deduction on the return. You can tell exactly what each
12 company is taking for that deduction. The windfall
13 profits tax would be an itemized deduction. You can tell
14 exactly what that would come to be. You would look at
15 their net liability and you could add back 9.4% of each
16 of those deductions for all the corporations. You would
17 be right back at where 43.21 is today. That would not be
18 hard. As for whether a future legislature would want to
19 use this as a yardstick or not, of course, this legislature
20 can't bind future legislatures with that regard. Anything
21 that we had as a structure today, future legislatures
22 could decide to go back from a 30% share as the fair
23 amount to 25% or they could advance it if they felt it
24 was appropriate to do there, although I wouldn't recommend
25 that at this time without more guidance from the U.S.

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Supreme Court on that.

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MR. GARDINER:

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Go ahead and continue.

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COMMISSIONER WILLIAMS:

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All right. Thank you Mr. Chairman. Section 3 amends

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the deductions from production income in coming up with

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net taxable production income under the income tax.

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The addition of the language "or incurred" after the

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word "paid", so that it is "taxes paid or incurred".

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Elsewhere it occurs -- well, still payments or taxes,

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that are paid or incurred -- that allows taxpayers

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who are on accrual basis of accounting rather than on

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a cash basis of accounting to recognize those costs in the

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tax year when they recognize them themselves for their

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internal accounting and for their federal reporting

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purposes. It is not a substantially important thing -

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it is simply convenience. In other provisions where we

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had the discretion, we have allowed them to do it on a

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cash or accrual basis under the regulations. Section 7

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removes the cap on the interest limitation creating a

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presumption - the presumption is set forth in a new

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section 7 or new section F, I mean, which appears on the

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top of page 5. It just simply sets the criteria by which

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3 a corporation will be able -- or taxpayer -- will be
4 able to rebut the presumption. It is only a presumption
5 now instead of an absolute ceiling. Item 9, General
6 Overhead and Administrative Expense, once again, creates
7 a presumption and allows it to be rebutted under the
8 new subsection F. On page 4 we have the deduction for
9 this 70% amount, right here, that indicates a
10 regional corporation can deduct from its gross income,
11 the 100%, it can deduct the 70% it really doesn't see,
12 that it distributes out. The new number 11 allows for
13 the payment of the reserves tax, or deduction for the
14 reserves tax which exceeds the credits which are
15 applied. If I may go back to my first illustration,
16 you recall this is the reserves tax backstopping this
17 part was reflected by a credit, this was actual payment.
18 That's real cost out-of-pocket of the corporation. This
19 is what has been allowed under this new 11 to be a
20 deduction in computing their taxable production income.
21 Number 12, innocently enough, or innocent looking
22 enough section 4986 of the Internal Revenue Code imposes
23 the windfall profits tax.

24 MR. GARDINER:

25 So this is the mechanism by which they can deduct the

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3 windfall profits tax.

4 COMMISSIONER WILLIAMS:

5 That's exactly right. Item 12 there, on lines 23 through
6 26. I've already discussed section 4 of the bill that
7 adds a new subsection (f) which provides for the rebutting
8 of the presumptions that limit interest and administrative
9 expense. Section 5 of the bill replaces -- this is under
10 the portion of the income tax, the present income tax,
11 where we use book income at the present time -- this
12 would change it to be federal taxable income other than
13 their income from the production or pipeline transportation
14 of oil and gas.

15 MR. SACKETT:

16 What page are you on?

17 COMMISSIONER WILLIAMS:

18 I am now on page 5.

19 MR. GARDINER:

20 Line 7.

21 COMMISSIONER WILLIAMS:

22 This will eliminate the differential treatment between
23 chapter 20 taxpayers and chapter 21 taxpayers with
24 respect to income other than that earned from oil and gas
25 or pipeline transportation in the state. Thus it becomes

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3 neutral to a taxpayer which chapter you fall under,
4 other than, of course, the income from production and
5 pipeline transportation. Section 6 allows -- well, it
6 makes explicit what we believe is already implicit
7 in the law. We've adopted a regulation to this effect.
8 This would provide clear statutory authority, clearer
9 statutory authority - I believe there is adequate
10 statutory authority, but it has been raised in the
11 lawsuit. Why leave a loose issue hanging. So this
12 makes explicit that the Commissioner of Revenue may
13 provide administrative relief in a case where a taxpayer
14 can demonstrate in fact that there is duplicative
15 taxation resulting from our tax scheme.

16 MR. MALONE:

17 Mr. Chairman, on that issue there, I think the authority
18 to provide administrative relief if in fact there is
19 over-taxation or unfair taxation - something beyond the
20 law going on - I think is in the present law. But has
21 administrative relief been applied for?

22 COMMISSIONER WILLIAMS:

23 Not at this time. That's one of the issues in the
24 case, Mr. Chairman. Whether in fact the administrative
25 remedies have been exhausted. The position of the

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3 litigants has been that our regulation, which offers
4 relief, lacks statutory authority, that we are powerless
5 to provide it.

6 MR. MALONE:

7 The State of Alaska, which is the taxing authority,
8 maintains and, apparently, is willing to offer
9 administrative relief. The taxpayer is saying that
10 they don't have the statutory authority to do it?
11 Is that ...

12 COMMISSIONER WILLIAMS:

13 That's correct.

14 MR. MALONE:

15 Thank you.

16 COMMISSIONER WILLIAMS:

17 Section 7 also relates to an issue in the lawsuit. Our
18 regulations -- this is on page 6, that's correct -- the
19 new language is in line 7. Our regulations require
20 quarterly payments of estimated tax. This is consistent
21 with the practice under the Internal Revenue Code, and
22 in fact, the Internal Revenue Code, when it refers to
23 installments does contemplate both installments after
24 the due date as well as prepayments before it.
25 Nevertheless, it has been raised in the lawsuit that this

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3 only means payments after the due date. Since we
4 were requiring installments of estimated tax before the
5 due date this amendment would provide clear statutory
6 authority for our regulation. It is just one more
7 loose issue in the case that I think is a rogue issue
8 but it is there nonetheless, and it is pointless to allow
9 it to continue. Section 8 enacts the new reserves tax.
10 I have already run through, briefly, the provisions in
11 43.58.011, which is the findings and purposes. If you go
12 to page 9, starting on line 6, you get to the operative
13 provisions of the tax. 43.21 imposes -- 43.58.021 imposes
14 the ad valorem tax for the first tax year beginning
15 July 1, 1981. This coincides with the State's fiscal
16 year. It allows, with this assessment date and this
17 beginning date for the tax year, it allows us to come in
18 with an assessed value in ample time for the legislature
19 to consider what the millage rate should be. Again,
20 with the January 1 deadline, and a June 30 payment period
21 under 43.56, which is how the other ad valorem tax is
22 structured, we essentially are given only half a year
23 in which to make the assessments, go through the appeals,
24 certify the final roll and send out the bills. This would
25 give us a whole year to do so. It is better.

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3 MR. COLLETTA:

4 Commissioner, is there a conflict between the reference
5 to transportation system of oil and gas on page 5, and then,
6 the exemption on page 8? Lines 9 and 10, Tom, on page 5,
7 and then go to lines 1, 2, 3, and 4 of page 8.

8 COMMISSIONER WILLIAMS:

9 No, that's not inconsistent, Mr. Chairman, because on page 5
10 the reference to income from pipeline transportation and
11 from worldwide production is reducing, it's a deduction,
12 an exclusion, from the worldwide pie of income that is to
13 be sliced under section 40. We've already accounted
14 for the Alaska pipeline income and the Alaska production
15 income and it's no longer appropriate to take a slice --
16 at least under this the conclusion follows that we
17 shouldn't be taking a slice out of that type of income
18 where they earn it in other jurisdictions. That is what
19 those lines on page 5 relate to. That is not
20 inconsistent with the finding on page 8, on lines 1-4,
21 that natural gas has been slow to develop up here.
22 It certainly has been slow to develop up here. We've
23 had partial development but it has not been -- you know,
24 there is still a lot undeveloped. Continuing on page 9,
25 then, lines 6-8 impose the tax. Lines 9-11 set the rate

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3 at 25 mills unless a different rate is set by the end
4 of February of the tax year. The reason the end of
5 February is important is simply that later on you will
6 see that we have to send the bill out by the 15th of
7 March. That gives us two weeks, once we know what the
8 millage is, assuming that if there were to be a change,
9 that would give us two weeks to get all the tax bills
10 prepared and out in the mail and meet our deadline.
11 It is a rule of practicality - whenever you are going
12 to have the tax bills get sent out then sometime before
13 that you have to say, Okay, this is what the millage is
14 going to be for that year. That is what this does. It
15 is obviously not a real attempt at the legislature to
16 limit itself - it is simply to make it clear how the
17 system works. This represents a practical deadline.
18 The legislature, of course, is free to rewrite the
19 provisions if, in the future, it chose to do so. But just
20 as an operating thing the ordinary expectation is that
21 by the end of February if you haven't changed the millage
22 rate it will be 25 mills. We'll send out the tax bills
23 accordingly. And we'll do so within two weeks. Section 31,
24 which is starting on lines 12-24 on page 9, provides for
25 exemptions from the reserves tax. It exempts the State's

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3 interest, since it is pointless to tax ourselves. It
4 exempts an interest owned by the United States, since
5 we cannot do so. It exempts property that we are pre-
6 empted from taxing by the laws of the United States -
7 this includes, native lands that have been exempted under
8 section 21(d) of the Alaska Native Claims Settlement
9 Act. When you read the Act it says that the developed
10 lands may be taxed by -- may be subject only to local
11 tax, is the only reference. Earlier in the legislative
12 history of the bill there are different versions that
13 make it clear that it was intended that the local
14 governing body, where the tax, where the shareholders
15 of the corporation would essentially be the constituency
16 of that local government. If they chose to tax them-
17 selves, that would be okay. It was not contemplated
18 in the history that the State do so. One has a lawsuit
19 if one wants to find out for sure whether that is in
20 fact a preemption or not. It is our opinion, it is my
21 opinion anyway, that as a matter of policy. We do
22 not have to engage in that. It may well be legal opinion
23 that we should not engage in that because of the risk
24 of loss. This simply says as a matter of policy that we
25 will not do so. There was a valid policy in the original

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3 decision of the Congress, and that we should respect
4 that, and that we probably are in fact preempted from
5 going contrary to that policy.

6 MR. ROGERS:

7 But later on in section 10 you do say that if that is
8 taken to court and we lose then it is stricken.

9 COMMISSIONER WILLIAMS:

10 That's correct.

11 MR. ROGERS:

12 You provided a backstop in case something goes
13 wrong.

14 COMMISSIONER WILLIAMS:

15 That's correct. The third exemption is gas reserves.
16 As I said, there has been some development of our gas
17 reserves but by far the largest portion of the
18 reserves in the State are undeveloped and it seems that
19 a reserves tax at this time could impair that development
20 unduly.

21 MR. ROGERS:

22 I'm concerned and perhaps jumping forward a little bit --
23 your definition of the word "gas" later on in the bill
24 is not oil, and then your definition of oil is crude
25 petroleum and other things separated from gas. It seems

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3 to me that those two end up running-round-robin.

4 It would be on page 16, lines 4-8.

5 COMMISSIONER WILLIAMS:

6 Well, those -- they really don't. Those definitions,
7 one saying what oil is and then saying gas is not oil.

8 In fact, have been used in production tax and there is
9 a reference to a gas processing plant. But that's fairly

10 clear what is meant by that - that's the liquid
11 extraction plant that you see in the Cook Inlet area.

12 There are two of those there. It would be any field
13 conditioning plant readying the gas at Prudhoe Bay

14 for delivery into the next facility down stream from
15 the fuel production facility. It does say that it's --

16 well, it says other hydrocarbons regardless of gravity
17 implicit, it's API gravity. Necessarily then you are

18 a liquid hydrocarbon, not in a gaseous state, although
19 you can originally recover it in a gaseous state.

20 A number of these have a boiling point close to room
21 temperature and others evaporate quickly at room

22 temperature so they exist partly in gas and partly in
23 liquid. It's the liquid state here that we are referring

24 to. Section 41, going back on page 9, section 41(a)

25 allows the current year tax under 43.21 to be a credit

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3 against the reserves tax liability. Section 41(b) allows
4 income tax payments in the past under chapter 21 for the
5 tax years 78-79-80, and in fact the first quarterly
6 estimate for tax year '81. Those past tax payments
7 will be also allowed as a different kind of credit
8 against the tax liability. The distinction between
9 the two types of credit becomes clear in subsection (c).
10 The current year, section (a) credit if you will, only
11 can be applied against the reserves tax, the current
12 reserves tax. The past year tax credits, the tax
13 credits for past income tax payments, can be carried
14 forward and are to be carried forward until they are
15 completely used up. Since it is contemplated that the
16 reserves tax will be as large, or larger, than the
17 income tax during all or most of the period while
18 litigation may be pending on the income tax, there is
19 no danger that the section (a) credits will in fact -- they will
20 be fully used up each year, we expect. In fact, there
21 will be enough left over to allow the application of
22 section (b) credits and use that up either by the end
23 of fiscal year '83 or by the end of fiscal year '84,
24 which I described earlier. Section (d) allows individual
25 persons or trusts that engage in oil or gas production

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3 or pipeline transportation to take credits for the tax
4 and say they are not corporations - they were not subject
5 to chapter 21. But they were in the same shoes as a
6 chapter 21 taxpayer otherwise. They paid income tax
7 and they engaged in the same activity. This allows for
8 the credit of the tax that they paid under chapter 20
9 simply by virtue of the fact that they were individuals or
10 a trust rather than having been corporations. In fact,
11 this will only apply to the 1978 tax year because for
12 corporations and fiduciaries the income tax was repealed
13 starting with the tax year 1979.

14 MR. COTTEN:

15 Can you give us an example of somebody who might fall
16 under that category?

17 COMMISSIONER WILLIAMS:

18 I can't really tell you a name because -- yes I can. If
19 you think of the interest at Prudhoe Bay. Of course, you
20 have -- I'm not confirming if they have paid taxes
21 under 20 or 21 because that may be confidential
22 information -- but look at the ownership at Prudhoe Bay.
23 You find there is ARCO, there is SOHIO, there's Exxon,
24 there's Phillips, Mobil, there's Chevron and so on, and
25 then there's the Nelson Bunker Hunt interest, William

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3 Herbert Hunt Trust estate, another Hunt Trust estate,
4 Hunt Industries and Placid Oil - some of those may be
5 corporations and some of those may have been under
6 chapter 20.

7 MR. COTTEN:

8 So if they now fall under the requirements of the
9 reserves tax and they paid tax under 43.20 then they
10 would be the same as if they paid under chapter 21 as
11 far as the credits are concerned.

12 COMMISSIONER WILLIAMS:

13 That's correct. That's to afford equal treatment to
14 people -- because all people are subject to the reserves
15 tax regardless of whether they are corporations or not.

16 MR. COTTEN:

17 Thank you Mr. Chairman.

18 MR. ROGERS:

19 So an individual who is now not paying any income tax
20 could essentially deduct an amount from the reserves
21 equivalent to what they would have paid?

22 COMMISSIONER WILLIAMS:

23 No. The only deduction is actual payments. If his income
24 tax payments are now zero, his deduction is zero. His
25 credit is zero.

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3 MR. ROGERS:

4 ...net increase in taxes. Overall, the backstop ends
5 up hitting the industry as a whole at approximately the
6 same level. For those sole proprietorships or individually
7 owned, their effective tax rate will increase.

8 COMMISSIONER WILLIAMS:

9 It will be restored to a comparable level as those who
10 happen to be corporations engaged in the same activity.
11 You see, what happened with the repeal of the individual
12 income tax is that these people were -- their tax
13 liability under chapter 20 was repealed. A new tax
14 liability is now being imposed on the industry as a
15 whole without differentiation to the happenstance
16 of whether a taxpayer is a corporation or not.

17 MR. ROGERS:

18 Can you provide the Committee with how many people or
19 the number of how many people will be involved...

20 COMMISSIONER WILLIAMS:

21 To the best of my knowledge it's only the interests in
22 Prudhoe Bay that are individuals. Or trusts.
23 Subsection (e) provides that if there is an adjustment
24 in the tax year, in the income tax liability, after the
25 credit for that tax year has already been taken, that the

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3 credit is to be adjusted to reflect whatever adjustment
4 that was made in the original tax liability. On page 11,
5 the assessment requires first, in subsection (a), that
6 the Department will assess taxable property as of July 1
7 each year. Section (b) sets out what the standard is in
8 assessing it. The full and true value being the
9 estimated price that the property would bring between a
10 willing buyer and a willing seller and they both know what
11 they are doing. The Department is to consider all factors
12 that may affect the value of the property and then
13 specifically, but not limited to, the Department is to
14 consider discounted present value of the expected future
15 net income from the proven reserves. Subsection (c)
16 is something that we did in the original reserves tax too,
17 namely, in assessing the income -- if we look at an
18 income stream we are not including in the assessed value
19 of the reserves the value represented by the hardware
20 that is already in place and which is already being
21 taxed under 43.56. We deduct that assessed value out -
22 it gets taxed under 43.56. The remaining value is what
23 is taxed under the reserves tax. In section (d) there
24 is a presumption about what the discount rate should
25 be when discounting to present value. The discount rate

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3 is presumed to be 10 percentage points over the rate
4 of inflation, the average rate of inflation over the
5 preceding five years as measured by the implicit
6 GNP deflator, which is published by the U.S. Department
7 of Commerce. There is provision in there about the
8 standard of proof that a taxpayer must meet in order
9 to rebut that presumption. By the way, that standard
10 of proof seems to be consistent with what the case
11 laws have held as the standard for a taxpayer to
12 rebut an assessor's decision. It is not something
13 which we made up - it is something consistent with
14 precedent. In section 61 on page 12 provides that we
15 prepare an assessment roll which sets out -- this is
16 the ordinary assessment roll that any municipality or
17 taxing jurisdiction with a property tax does. You set
18 out a description of the property, the value of the
19 property and the names of the people who are going to --
20 who own it. Section 71 requires that by the 15th of
21 October we send a notice out to the owners of the
22 property - a preliminary assessment, what we think it is
23 worth.

24 MR. ROGERS:

25 Is that a public record.

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3 COMMISSIONER WILLIAMS:

4 Yes. By the 15th of October for each year we send
5 out our preliminary estimate of what the assessed
6 value is. That is the same thing as the notice
7 that you get if you live in Anchorage or you live in
8 Juneau - you probably have gotten already your notice
9 of assessment. That's all it is. It simply says what
10 the assessed value is. Preliminarily. If the taxpayer
11 disagrees, then he proceeds under section 81 that starts
12 on line 14 on page 12. Then 20 days, he may appeal the
13 assessment. The appeal will be in a formal hearing
14 under the regular procedures for tax appeals provided
15 in 43.05.240. At the hearing the appellant will bear the
16 burden of proof and if he fails to present any proof as
17 -- to justify a different value then he has failed
18 to meet the burden and failing to meet the burden means
19 the assessment is to be upheld. On the other hand, if he
20 does meet his burden of proof and the Department determines
21 that a correction should be made, then the Department
22 must make it. If after the appeal, the taxpayer is still
23 dissatisfied with the Department's decision then he
24 has 30 days in which to get into court. Section 91 of --
25 the new section 91 of the tax provides that by the 1st of

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3 February, at the latest, we certify the final assessment
4 roll. This, again, is a public document. This will be --
5 the final roll, will be in fact what determines the
6 liability at 25 mills. From that the legislature will
7 be able to determine whether an adjustment is warranted
8 in the millage rate. Obviously, if there are any material
9 differences we would notify the legislature earlier
10 rather than waiting right up to the 1st of February, of
11 those differences. Section 101 allows for supplemental
12 assessment rolls - that's simply if there is something
13 out there that no one reported to us and we weren't aware
14 of it ourselves, and later on we find out that it is there
15 and should have had an assessment, then we can put them
16 on an assessment roll. They don't escape taxation for
17 that year. Section 111 is standard language allowing
18 us to conduct investigations. It is essentially the same
19 as section 110 in the present 43258 which was used when
20 the reserves tax was active in '76 and '77. Section 121
21 simply provides that the standard limitations on
22 assessment collection and refund for taxes apply to
23 this tax, except that a redetermination of tax is not
24 subject to those limitations redetermination of
25 reserves tax. Meaning if there is an adjustment in the

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3 credit against the reserves tax then you can recover
4 the change in the actual tax liability. Going back here
5 again, that is simply to say, if this changes up or
6 down, then the amount of actual liability that is paid
7 will still be free to go up or down regardless of what
8 those other provisions may provide. We are not cut off
9 by the statute of limitations. If there were a court
10 decision and it came down more than three years after
11 the original payment - we could still adjust the
12 payment either upward or downward. Section 131 is
13 parallel to the existing provisions in the reserves
14 tax about who pays the tax. Section 141, on page 15
15 starting on line 22, says the Department may adopt
16 regulations to implement the tax. And section 151
17 contains definitions of the various terms that have
18 been used. I think we already discussed the definition
19 of gas and oil. Section 9 of the bill, starting on
20 line 4 of page 17, is statement of intent about the
21 credit provisions. It is basically an explicit
22 statement of intent, an intent to be severable, that
23 if 43.58.041, the credit provisions, in any way
24 imperil the basic tax structure, then that portion is
25 void. The credit provision is void. Similarly, in

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3 section 10 of the bill, if one of the three exemptions
4 from reserves tax is held invalid or if any, one or more
5 are held invalid, and that is a final decision, then
6 that's a void exemption. There is the intention that it
7 be severable rather than all or nothing for the basic
8 tax itself. Section 11 makes it clear that if the
9 separate accounting approach that is used in chapter 21
10 for income tax purposes is declared to be invalid,
11 which is the risk that we have from the Mobil and Exxon
12 cases that the Supreme Court decided last year - if that
13 risk comes about then nevertheless corporations are
14 liable under the regular income tax rather than having
15 no income tax liability whatsoever. That should be
16 implicit, but this section is in here to make it
17 absolutely clear that that is the intent. Section 12
18 provides that even though the standard levy is 20 mills
19 for the -- 25 mills for the reserves tax, the first
20 tax year it will be 30 mills. (d) of section 12
21 limits the amount of credit that may be applied.
22 Ordinarily, the credit may be applied so that when you take
23 current year credits, which may be this much, plus past
24 year tax credits, that the total amount of credit may
25 not exceed three quarters of the overall liability.

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3 In other words, payment will equal 25%, at least, of
4 the gross reserves tax liability. This exception says
5 that for the first year, instead of being 25%, the
6 minimum payment will be at least one third of the gross
7 liability, and so the combination of credits for past
8 income tax payments as well as the current year income
9 tax payment may not exceed two thirds of the reserves
10 tax liability. This allows us to come so close, in fact,
11 to a push situation between revenues under this bill and
12 revenues that we would receive under chapter 21, the
13 income tax with no further changes.

14 MR. ROGERS:

15 Without that section (b) we would be receiving less
16 income from -- in FY 82 than under the current law --
17 that would be made up in future years, is that right?

18 COMMISSIONER WILLIAMS:

19 That would be made up in future years, but you would have
20 a couple of hundred million dollars, 250 or thereabouts,
21 million dollars less revenue in fiscal year '82.

22 Section 13 was in the original bill that repeals 43.21.040(d)
23 and (e). I don't have those -- I failed to bring those
24 provisions with me. I believe I explained those in
25 earlier testimony. One of those, I think, is the -- relates

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3 to OCS. I think they may both relate to that - I'm not
4 sure. It's not simply technicality, but it -- these are
5 for purposes of strengthening the case over 43.21.

6 They are basically what?

7 MR. GARDINER:

8 Compensation and the property issues in ...

9 COMMISSIONER WILLIAMS:

10 Fine. Then there is a bunch of repealers. The first
11 two are simply 43.55.011(d) - is now a moot provision
12 of the statute - it required that there be a payment
13 of a nickel a barrel into the Native Claims Settlement
14 Fund for each barrel that was subject to a cents per
15 barrel tax, since the Native Claims Fund liability
16 has been fully paid that provision is no longer an
17 operative item in the law and it's best just to repeal
18 that from the books. 43.55.012(a) requires the
19 Department to make a recommendation each year about cents
20 per barrel rates and report on -- in light of current
21 market conditions and everything else. Everybody seems
22 quite comfortable with the percentage of value tax and
23 in fact, in light of the effects it would have on the
24 windfall profits tax, cents per barrel increases are
25 deemed to be discriminatory against the windfall portion

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3 and therefore not deductible under the windfall profits
4 tax. Any change in those rates now would invite a new
5 issue into whatever litigation may be pending. It is
6 best, in effect, to treat that as a dead letter and
7 repeal that. 43.55.018 relates to the application of
8 early development incentive credits against the
9 production tax for reserves tax payments when the
10 reserves tax was in effect in '76 and '77. That is no
11 longer part of this structure, and so it is repealed.
12 All of the present provisions of 43.58 are repealed
13 and the reason that was done was because of the provision,
14 I think in section 170 of chapter 58, which says this
15 act expires on June 30, 1978 or whatever it is. There is
16 an expiration date, anyway, there, so there is some
17 question whether that operated to repeal all the other
18 provisions or not. That is why we set out a whole new
19 series of things that are essentially parallel so
20 that you find counterparts. The old 43.58.010 is now
21 43.58.011, and so on down through. That is simply to
22 avoid any question about whether existing provisions
23 are repealed or not repealed. They are repealed -
24 the new ones are enacted. The "warts" part of this
25 bill and the windfall profits tax exemption are made

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3 retroactive to the beginning of 43.21 under section 15
4 of this bill. The reserves tax provisions take effect
5 on July 1. The Act itself has an immediate effective
6 date. And that only took 35 minutes!

7 MR. GARDINER:

8 Since several people have meetings to go to, we will
9 come back at 12:30 tomorrow. We do have a lot of
10 people to testify so we will try to start on time
11 and take any questions of the Commissioner that people
12 have first, then we will go on. Most of the people
13 who are testifying, I think, all of them, are from
14 out of town tomorrow. As a courtesy to them, if
15 everybody ... If people want to leave their folders,
16 we will have them available.

17 MR. MALONE:

18 Mr. Chairman, before you adjourn, it might be helpful
19 to the Commissioner if people have some involved
20 questions they should get them to you or to the
21 Commissioner as early as possible.

22 MR. GARDINER:

23 That's a good suggestion. Maybe you could give any
24 questions people have to Mark so he may have answers
25 prepared.

(meeting adjourned 2:00 p.m. May 20)

J&R Associates